

Message Text

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SUBJECT: SUMMIT MACROECONOMIC GROUP: COUNTRY NOTES AND
TABLE

REF: STATE 124923

THERE FOLLOWS TEXT AND TABLE REFERRED TO IN REFTEL, FROM
CEA CHAIRMAN SCHULTZE TO OTHER MACROECONOMIC GROUP MEMBERS.

BEGIN TEXT.

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UNITED STATES -- REAL OUTPUT IN THE UNITED STATES DECLINED
SLIGHTLY IN THE FIRST QUARTER OF 1978, LARGELY AS A RESULT
OF THE LONG COAL STRIKE AND SEVERE WEATHER CONDITIONS IN
JANUARY AND FEBRUARY. THERE WAS A SHARP REBOUND IN MOST
INDICATORS OF ECONOMIC ACTIVITY BEGINNING IN MARCH AND THUS
THE SECOND QUARTER IS LIKELY TO SHOW AN EXTRAORDINARILY
LARGE JUMP IN OUTPUT. GROWTH AT A MORE MODERATE RATE SHOULD
CONTINUE THROUGH THE REST OF 1978 AND 1979. PRIVATE
FORECASTS FOR U.S. REAL GNP GROWTH IN 1978 CLUSTER ABOUT
3 3/4-4 PERCENT (YEAR OVER YEAR). GROWTH OVER THE FOUR

QUARTERS OF 1978 IS EXPECTED TO EXCEED THE YEAR-ON-YEAR INCREASE, PARTIALLY BECAUSE OF THE WEAK FIRST QUARTER. UNEMPLOYMENT HAS ALREADY SHOWN A SIGNIFICANT DROP SINCE LATE

1977, AND MAY SHOW A SMALL FURTHER REDUCTION OVER THE REST OF THIS YEAR.

THE PRINCIPAL FACTOR ADVERSELY AFFECTING THE OUTLOOK FOR REAL GROWTH IS THE OUTLOOK FOR INFLATION. STRONGER FOOD PRICE INCREASES THAN EXPECTED EARLIER AND THE DEPRECIATION OF THE DOLLAR SINCE LAST SUMMER HAVE LED TO UPWARD REVISIONS OF INFLATION FORECASTS. THE RISE OF AVERAGE HOURLY EARNINGS, WHICH ACCELERATED IN THE FOURTH QUARTER OF 1977 AND THE FIRST QUARTER OF 1978 AFTER MODERATING IN 1975 AND 1976 AND REMAINING RELATIVELY STABLE THROUGH THE FIRST THREE-QUARTERS OF 1977, IS ALSO A MATTER FOR CONCERN. IN VIEW OF THE LESS FAVORABLE INFLATION OUTLOOK AND THE GREATER-THAN-EXPECTED DECLINE IN UNEMPLOYMENT IN EARLY 1978 U.S. OFFICIALS HAVE REDUCED THE SIZE OF PROPOSED TAX CUTS FROM 25 BILLION DOLLARS TO 20 BILLION DOLLARS AND POSTPONED THEIR EFFECTIVE DATES FROM OCTOBER 1978 TO JANUARY 1979. THE U.S. ADMINISTRATION HAS ALSO INSTITUTED AN ANTI-INFLATION POLICY TO (1) UNWIND THE MOMENTUM OF INFLATION THROUGH
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VOLUNTARY COOPERATION TO DECELERATE PRICE AND WAGE INCREASES IN THE PRIVATE SECTOR, (2) REDUCE THE POTENTIAL FOR PRICE SHOCKS AND MINIMIZE THE DIRECT CONTRIBUTION OF GOVERNMENT ACTIONS TO INCREASES IN COSTS AND PRICES, AND (3) INSTITUTE MEASURES SUCH AS JOBS AND TRAINING PROGRAMS DIRECTED AT REDUCING THE RATE OF UNEMPLOYMENT AT WHICH WAGE RATES BEGIN TO ACCELERATE.

THE LAGGING SECTOR IN THE CURRENT U.S. RECOVERY HAS BEEN BUSINESS FIXED INVESTMENT. ALTHOUGH GROWTH IN INVESTMENT SINCE THE TROUGH HAS BEEN OF AVERAGE CYCLICAL PERFORMANCE, THE PRIOR RECESSIONARY DECLINE HAD BEEN UNUSUALLY DEEP. PART OF THE WEAKNESS OF INVESTMENT IS RELATED TO LOW CAPACITY UTILIZATION RATES. IN ADDITION, INCREASED UNCERTAINTIES CONCERNING FUTURE ECONOMIC DEVELOPMENTS AND HIGH COSTS OF EQUITY CAPITAL HAVE IMPEDED INVESTMENT. THE ADMINISTRATION HAS MADE LEGISLATIVE PROPOSALS FOR TAX INCENTIVES TO STIMULATE BUSINESS FIXED INVESTMENT.

THE U.S. CURRENT ACCOUNT DEFICIT EXCEEDED 20 BILLION DOLLARS IN 1977 AND MAY BE SEVERAL BILLION HIGHER IN 1978, GIVEN THE LARGE JUMP IN THE TRADE DEFICIT THAT OCCURRED IN THE FIRST QUARTER. A LARGE DROP IN THE TRADE DEFICIT FROM THE FIRST QUARTER LEVELS CAN BE EXPECTED OVER THE COURSE OF THE REST OF THE YEAR, HOWEVER. THE PROSPECTS FOR FURTHER IMPROVEMENT IN 1979 HINGE CRUCIALLY ON THE GROWTH OF DEMAND ABROAD AND INSTITUTING AN ENERGY POLICY THAT BEGINS TO

HOLD DOWN IMPORTS OF PETROLEUM.

CANADA -- INDICATORS OF ECONOMIC GROWTH IN CANADA WERE WEAK IN EARLY 1978 AND GROWTH IN THE SECOND HALF OF 1978 IS EXPECTED, AT BEST, TO KEEP PACE WITH THE GROWTH OF POTENTIAL OUTPUT. PRIVATE FORECASTS FOR 1978 GNP GROWTH ARE CLUSTERED AROUND 4 PERCENT, INDICATING THE UNEMPLOYMENT RATE IS UNLIKELY TO COME DOWN AND MAY RISE FURTHER. MOREOVER, DEVELOPMENTS DO NOT POINT TO STRONGER GROWTH IN 1979.

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THE FISCAL YEAR BEGINNING APRIL 1, 1978 IS EXPECTED TO RESULT IN A FEDERAL DEFICIT EQUAL TO 4.0 PERCENT OF GNP -- HIGH BY HISTORICAL STANDARDS BUT SLIGHTLY LESS THAN THE DEFICIT IN THE 1977 FISCAL YEAR. THE EXPANSIONARY IMPACT OF RECENT FEDERAL DEFICITS HAS BEEN SOMEWHAT OFFSET BY SMALLER PROVINCIAL AND LOCAL DEFICITS. MOREOVER, MONETARY POLICY, WHICH HAS AS A MEDIUM-TERM OBJECTIVE THE ACHIEVEMENT OF A TARGET PATH OF M1, HAS RECENTLY BEEN INFLUENCED BY CONCERNS OVER THE WEAKNESS OF THE CANADIAN DOLLAR. THUS, INTEREST RATES HAVE RISEN SIGNIFICANTLY.

THE REDUCTION IN THE INTERNATIONAL VALUE OF THE CANADIAN DOLLAR OVER 1977 AND EARLY 1978 HAS ADDED TO INFLATIONARY PRESSURES, BUT THEY ARE EXPECTED TO ABATE OVER THE COURSE OF 1978 AND BE OF MUCH LESS SIGNIFICANCE IN 1979. THUS, THE RISE IN THE CONSUMER PRICE INDEX MAY SLOW FROM LAST YEAR'S ADVANCE OF 8 PERCENT, BUT IT IS UNLIKELY TO BE LESS THAN 7 PERCENT THIS YEAR. A PHASED PROCESS OF WITHDRAWAL OF THE PRICE AND INCOMES CONTROLS THAT HAVE BEEN IN FORCE SINCE 1975 HAS BEGUN; HOWEVER, A SUBSTANTIAL PORTION OF THE CANADIAN ECONOMY WILL REMAIN SUBJECT TO CONTROLS UNTIL THE END OF THIS YEAR. WITH THE PRESENT SLACK IN THE CANADIAN ECONOMY, LITTLE SUPPRESSED PRESSURE FOR WAGE AND PRICE INCREASES IS LIKELY TO EMERGE AS CONTROLS ARE WITHDRAWN.

BUSINESS FIXED INVESTMENT IN CANADA REMAINED STRONGER DURING 1975 THAN IN OTHER LARGE COUNTRIES, BUT SUBSEQUENT SLUGGISH INVESTMENT GROWTH HAS BEEN A SIGNIFICANT DRAG ON THE EXPANSION OF DOMESTIC DEMAND. STRONG INVESTMENT IN THE ENERGY SECTOR IS EXPECTED TO ACCOUNT FOR HALF OF TOTAL INVESTMENT OUTLAYS IN THE NEAR-TERM AND KEEP THE RATE OF INVESTMENT GROWTH AT ABOUT THE GROWTH RATE FOR TOTAL GNP. LOW

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CAPACITY UTILIZATION -- CURRENTLY 3.2 PERCENTAGE POINTS BELOW THE AVERAGE FOR THE PERIOD 1961 TO 1976 -- MAKES IT UNLIKELY THAT INVESTMENT GROWTH WILL LEAD A STRONG RECOVERY.

THE CANADIAN CURRENT ACCOUNT BALANCE COULD BE MARGINALLY

SMALLER THAN THE 4 BILLION DOLLAR DEFICIT RECORDED IN 1977. GROWING NET INTEREST PAYMENTS MAKE A SHARP IMPROVEMENT UNLIKELY, HOWEVER. CANADIAN CURRENT ACCOUNT DEVELOPMENTS

DEPEND MOST ACUTELY ON ECONOMIC AND FINANCIAL DEVELOPMENTS IN THE UNITED STATES, BUT STRONGER GROWTH IN THE REST OF THE WORLD WOULD MAKE A SIGNIFICANT CONTRIBUTION TO THE GROWTH OF CANADIAN EXPORTS.

FEDERAL REPUBLIC OF GERMANY -- REAL GNP IN THE FEDERAL REPUBLIC GREW AT A 5.6 PERCENT ANNUAL RATE IN THE FOURTH QUARTER OF 1977, FOLLOWING TWO QUARTERS OF DECLINE. RECENT INDICATORS OF ECONOMIC ACTIVITY, HOWEVER, SUGGEST THAT EXPANSION HAS FALTERED SINCE THE BEGINNING OF THE CURRENT YEAR. TAX CHANGES EFFECTIVE JANUARY 1 SHOULD GIVE SOME IMPETUS TO DEMAND BUT MOST PRIVATE FORECASTS STILL PLACE THE GROWTH OF REAL GNP IN 1978 AT 3 PERCENT OR LESS.

THE APPRECIATION OF THE DM AND THE SLOW PACE OF EXPANSION IN THE REST OF EUROPE WILL HOLD DOWN GROWTH IN THE CRUCIAL EXPORT SECTOR. AT PRESENT RATES OF CAPACITY UTILIZATION, INVESTMENT DEMAND IS LIKELY TO REMAIN WEAK, ALTHOUGH GOVERNMENT INVESTMENT AND SOME LARGE PRIVATE PROJECTS THAT HAVE BEEN HELD UP BY REGULATORY AND LEGAL PROCEEDINGS SHOULD GET UNDERWAY. THE PROSPECT FOR A STRONG RECOVERY IN CONSUMER SPENDING IS DIM.

A RECORD OF WEAK INVESTMENT IN GERMANY PREDATES THE 1974-75 RECESSION. IN ADDITION TO THE PRESENCE OF LARGE MARGINS OF UNUSED CAPACITY AND RECENT LEGAL OBSTACLES TO INVESTMENT PROJECTS, INVESTMENT HAS BEEN AFFECTED BY A DECLINE
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IN THE RATE OF RETURN ON CAPITAL THAT STARTED BEFORE THE RECESSION AND HAS REDUCED PROFITS MORE THAN CAN BE EXPLAINED BY THE DEPRESSED STATE OF AGGREGATE DEMAND. IN PART, THIS SHIFT IN THE RETURN ON CAPITAL CAN BE ATTRIBUTED TO THE ALLEVIATION OVER THE COURSE OF THE 1960S OF THE RELATIVE CAPITAL SHORTAGE THAT HAD EXISTED IN THE FEDERAL REPUBLIC. AT THE OUTSET OF THE 1960S, RATES OF RETURN ON CAPITAL IN GERMANY WERE MUCH HIGHER THAN IN MOST OTHER ADVANCED COUNTRIES.

A STRONGER INVESTMENT PERFORMANCE IS NEEDED BOTH TO SUSTAIN A SUFFICIENTLY STRONG RECOVERY TO BRING DOWN DOMESTIC UNEMPLOYMENT RATES AND TO ENSURE SUFFICIENT CAPITAL STOCK TO AVOID REACHING PRODUCTION CONSTRAINTS BEFORE THE CYCLICAL COMPONENT OF UNEMPLOYMENT HAS BEEN ABSORBED.

CONSUMER PRICE INFLATION IN THE FEDERAL REPUBLIC HAS DROPPED BELOW THE AVERAGE FOR THE 1961-1972 PERIOD AND WOULD NOT APPEAR TO BE A SHORT-RUN CONSTRAINT ON ECONOMIC POLICIES.

THE RATES OF PRICE INFLATION OF LESS THAN THREE PERCENT THAT HAVE BEEN RECORDED RECENTLY HAVE BEEN PARTLY DUE TO

THE APPRECIATION OF THE DM AND ARE UNLIKELY TO BE SUSTAINED, BUT CONSUMER PRICES IN 1978 ARE LIKELY TO BE ONLY 3 TO 3 1/2 PERCENT ABOVE PRICES IN 1977.

THE CURRENT ACCOUNT SURPLUS OF THE FEDERAL REPUBLIC IS UNLIKELY TO BE REDUCED IN 1978 FROM THE 3.6 BILLION DOLLARS RECORDED IN 1978 DESPITE A WEAK OUTLOOK FOR MERCHANDISE EXPORT VOLUME. THE PERSISTANCE OF SURPLUSES OVER A NUMBER OF YEARS UNDER CONDITIONS WHEN MANY OTHER INDUSTRIAL COUNTRIES HAVE INCURRED DEFICITS HAS RESULTED IN A CUMULATIVE UPWARD MOVEMENT OF THE DM. SUCH MOVEMENTS HAVE FAR
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EXCEEDED THE AMOUNT ATTRIBUTABLE TO A BETTER INFLATION RECORD IN THE FEDERAL REPUBLIC. WHILE SUCH MOVEMENTS SHOULD CONTRIBUTE ULTIMATELY TO CURRENT ACCOUNT ADJUSTMENT, THE SLOW PACE OF DOMESTIC DEMAND GROWTH IN THE FEDERAL REPUBLIC HAS SO FAR INHIBITED ADJUSTMENT.

FRANCE -- MOST FORECASTS FOR FRENCH ECONOMIC GROWTH ARE IN THE RANGE OF 3.3 PERCENT, ROUGHLY 1 PERCENT HIGHER THAN LAST YEAR. THE GOVERNMENT IS PROJECTING A LARGER DEFICIT THIS YEAR THAN LAST, AND WITH THE UNCERTAINTY SURROUNDING THE ELECTION HAVING PAST, AN IMPROVED INVESTMENT PERFORMANCE IS EXPECTED.

REAL GROWTH IN 1979 IS LIKELY TO CONTINUE AT ABOUT THE SAME PACE AS 1978. UNEMPLOYMENT NOW STANDS AT OVER 5 PERCENT OF THE LABOR FORCE; WITH VERY RAPID GROWTH OF THE LABOR FORCE CONTINUING, IT IS UNLIKELY TO BE REDUCED EITHER THIS YEAR OR NEXT AND COULD WELL EDGE UP FURTHER.

THE FRENCH DEFICIT ON CURRENT ACCOUNT SHRANK FROM OVER 6 BILLION DOLLARS IN 1976 TO 3.2 BILLION DOLLARS IN 1977. A FURTHER DECLINE TO ABOUT 2 BILLION DOLLARS IS EXPECTED THIS YEAR. AT THIS LEVEL, THE CURRENT ACCOUNT WOULD NOT SEEM TO POSE A POLICY CONSTRAINT ON FRANCE. THE FRENCH FRANC HAS BEEN RELATIVELY STRONG FOR OVER A YEAR AND A HALF EXCEPT FOR A BRIEF PERIOD BEFORE THE ELECTION.

PROGRESS AGAINST INFLATION HAS BEEN SLOWER THAN HOPED FOR AS RAPID FOOD PRICE INCREASES IN THE SPRING AND SUMMER OF 1977 PUSHED UP THE RATE OF INCREASE OF THE CONSUMER PRICE INDEX. FOR 12 MONTHS ENDING IN FEBRUARY CONSUMER PRICES WERE UP 9.2 PERCENT. THE AVERAGE INCREASE IN RECENT MONTHS HAS BEEN LOWER, HOWEVER. THE GOVERNMENT IS MOVING TO DE-CONTROL INDUSTRIAL PRICES, AND SOME UPWARD ADJUSTMENT OF CONTROLLED PRICES IS PROBABLE. HENCE, INFLATION IS NOT LIKELY TO BE BROUGHT BELOW 9 PERCENT THIS YEAR.

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PUBLIC AND PRIVATE NONRESIDENTIAL INVESTMENT IN FRANCE REMAINED RELATIVELY STRONG THROUGH THE TROUGH OF THE RECESSION BUT WEAKENED IN 1976 AND THEN DECLINED OVER MUCH OF 1977. EVEN WITH THE RECENT WEAKNESS, HOWEVER, INVESTMENT HAS REMAINED NEARER TO ITS PRE-RECESSION SHARE OF GNP THAN IN MOST OTHER COUNTRIES. NON RESIDENTIAL INVESTMENT IS EXPECTED TO GROW A LITTLE FASTER THAN GNP THIS YEAR AND NEXT, BUT NOT BY ENOUGH TO FULLY MAKE UP FOR THE WEAKNESS OF THE PREVIOUS TWO YEAR.

UNITED KINGDOM -- AFTER STAGNATING THROUGH MOST OF 1977, THE UK ECONOMY APPEARS TO HAVE BEGUN GROWING AGAIN IN 1978, STIMULATED BY INCOME TAX REDUCTIONS ANNOUNCED IN OCTOBER 1977 AND APRIL 1978. BOTH CONSUMER EXPENDITURE AND PRIVATE SECTOR INVESTMENT HAVE PICKED UP. THE RISE IN UNEMPLOYMENT HAS BEEN ARRESTED AND RECENTLY THERE HAS EVEN BEEN A SLIGHT DECLINE. PRIVATE FORECASTS PLACE REAL GNP GROWTH AT 2 1/2 TO 3 PERCENT THIS YEAR AND, WITH PRESENT POLICIES, GROWTH WOULD BE UNLIKELY TO RISE ABOVE THE TOP OF THIS RANGE IN 1979. GROWTH OF ABOUT 3 PERCENT WILL PROBABLY BE NEEDED TO KEEP UNEMPLOYMENT FROM RISING.

INFLATION IS PROCEEDING AT THE MUCH REDUCED PACE ESTABLISHED SINCE LAST SPRING: BY MID-YEAR THE INCREASE IN RETAIL PRICES OVER A YEAR EARLIER SHOULD BE DOWN TO 7 PERCENT. THE BENEFITS FROM A RISING EXCHANGE RATE AND FALLING COM-MODITY PRICES IN BRINGING DOWN INFLATION CANNOT BE EXPECTED TO CONTINUE, HOWEVER. THE RATE OF INFLATION MAY THEREFORE RISE SLIGHTLY IN 1979 EVEN IF THERE IS SUBSTANTIAL FURTHER PROGRESS OVER THE COMING YEAR IN REDUCING THE GROWTH OF WAGE COSTS.

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RECENT TRADE FIGURES HAVE BEEN ERRATIC, BUT THE UNDERLYING POSITION OF THE CURRENT ACCOUNT IS PROBABLY A SMALL SURPLUS, ALTHOUGH NOT AT THE 3 BILLION DOLLAR ANNUAL RATE LEVEL OF THE SECOND HALF OF 1977. DOMESTIC DEMAND GROWTH MORE RAPID THAN CURRENTLY ENVISIONED WOULD RAPIDLY DISSIPATE THIS SURPLUS AND THREATEN THE STABILITY OF THE POUND IN EXCHANGE MARKETS, CREATING NEW INFLATIONARY PRESSURES. THUS, AD-DITIONAL EXPANSIONARY MEASURES ARE PRECLUDED UNLESS GROWTH ABROAD BECOMES STRONGER THAN CURRENTLY EXPECTED OR THE DOMESTIC EXPANSION FALTERS.

INVESTMENT IS CURRENTLY ON THE UPSWING IN THE UNITED KING-
DOM, BUT WITH WIDESPREAD SURPLUS CAPACITY INVESTMENT PLANS
COULD BE REVISED DOWNWARD UNLESS A STEADY RECOVERY IS

MAINTAINED. CONFIDENCE MUST BE NURTURED THAT BALANCE OF PAYMENTS DIFFICULTIES OR INCREASED INFLATION WILL NOT

NECESSITATE A ROUND OF GO-STOP POLICIES OF THE SORT THAT HAVE PRODUCED A WEAK INVESTMENT CLIMATE IN THE UNITED KINGDOM IN THE PAST. CONTINUED MODERATION IN NOMINAL WAGE SETTLEMENTS IS ALSO ESSENTIAL TO AVOID A SQUEEZE ON PROFITS FROM THE WAGE SIDE AND AN IMPAIRMENT OF REAL CASH FLOW FROM GENERALLY HIGHER INFLATION.

ITALY -- THE STABILITY OF THE ITALIAN ECONOMY WAS SUBSTANTIALLY ENHANCED IN 1977 AS THE CURRENT ACCOUNT MOVED INTO SURPLUS AND THE RATE OF INFLATION DECLINED TO 12.4 PERCENT FROM MARCH 1977 TO MARCH 1978. THE PRICE PAID FOR THESE RESULTS WAS A MARKED SLOWDOWN OF REAL GNP GROWTH TO ONLY 1.7 PERCENT FOR THE YEAR. A RECOVERY OF INDUSTRIAL PRODUCTION HAS OCCURRED IN EARLY 1978 BUT ONLY A MODEST IMPROVEMENT IN REAL GNP GROWTH TO ABOUT 2 TO 2 1/2 PERCENT IS EXPECTED FOR THE YEAR. THE GOVERNMENT IS AIMING TO GET THE GROWTH RATE UP TO 4 1/2 PERCENT BY THE END OF THE YEAR. REACHING THIS GROWTH RATE WILL ONLY BE POSSIBLE IF EXPORT GROWTH IS STRONG. ONLY IF SUCH A RESULT IS ACHIEVED AND
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MAINTAINED CAN THE CURRENT UNEMPLOYMENT RATE OF OVER 7 PERCENT BEGIN TO COME DOWN IN 1979.

HOPES FOR A SUSTAINED RECOVERY OF THE ITALIAN ECONOMY ARE TIED TO HOLDING THE RISE OF PRICES THIS YEAR TO AT MOST 13 PERCENT OR BETTER AND ACHIEVING A FURTHER REDUCTION IN 1979, GAINING BETTER CONTROL OVER THE GOVERNMENT BUDGET, AND MAINTAINING A SUSTAINABLE CURRENT ACCOUNT POSITION. THE LATTER WILL REQUIRE A SOLID EXPANSION OF DEMAND ABROAD TO SUSTAIN THE GROWTH OF EXPORTS. OTHERWISE THE STABILITY OF THE LIRA WILL BE THREATENED AND WITH IT ANY HOPES FOR FURTHER PROGRESS AGAINST INFLATION.

THE INVESTMENT SHARE OF GNP DECLINED FROM OVER 23 PERCENT IN 1976 TO 21 PERCENT IN 1977 AS CAPACITY UTILIZATION FELL BY MORE THAN 3 1/2 PERCENTAGE POINTS OVER THE COURSE OF THE YEAR. RISING INDUSTRIAL PRODUCTION IS A NECESSARY CONDITION FOR STRONGER INVESTMENT DEMAND. IN ADDITION, LABOR COSTS MUST BE HELD DOWN THROUGH MODERATION IN REAL WAGE INCREASES AND THE ESTABLISHMENT OF AN INDUSTRIAL RELATIONS CLIMATE MORE FAVORABLE TO INCREASED PRODUCTIVITY. ALSO, BARRIERS TO LABOR MOBILITY MUST BE REMOVED.

JAPAN -- REAL GNP IN JAPAN GREW 5.1 PERCENT IN 1977, WITH THE EXTERNAL SECTOR CONTRIBUTING A SIGNIFICANT PART OF THE INCREASED DEMAND. THIS GROWTH RATE WAS NOT SUFFICIENT TO PREVENT A RISE IN THE NUMBER OF UNEMPLOYED OR A DECLINE IN THE RATIO OF JOB OFFERS TO JOB SEEKERS. INDUSTRIAL PRODUC-

TION DECLINED OVER MUCH OF THE YEAR, BUT HAS RISEN

CONTINUOUSLY SINCE NOVEMBER AND IN MARCH STANDS 4.6 PERCFNT ABOVE THE YEAR-EARLIER FIGURE.

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THE GOVERNMENT TOOK STIMULATIVE FISCAL MEASURES IN A SUPPLEMENTAL BUDGET IN THE FALL OF 1977 AND AGAIN IN THE BUDGET FOR THE FISCAL YEAR BEGINNING APRIL 1, 1978. INTEREST RATES HAVE ALSO BEEN LOWERED. THERE HAS BEEN AN EXPECIALLY STRONG CONCENTRATION ON HOUSING FINANCE. THE GOVERNMENT'S STRATEGY IS FOR GROWTH LED BY THE GOVERNMENT SECTOR IN THE FIRST HALF OF THE FISCAL YEAR WITH PRIVATE SPENDING TURNING UP LATER.

THERE IS GREATER DIVERGENCE OF OPINION ABOUT GROWTH IN JAPAN THAN IN OTHER COUNTRIES. THE GOVERNMENT FORECASTS A FY 1978 GROWTH OF 7.0 IN REAL GNP. DESPITE SOME INDICATIONS OF GREATER STRENGTH IN THE ECONOMY AND THE EXPANSIONARY POLICY MEASURES THAT HAVE BEEN TAKEN -- AND CONDITIONAL ON CURRENT POLICY -- FEW PRIVATE FORECASTERS WOULD PUT GNP GROWTH ABOVE 5 1/2 PERCENT FOR CALENDAR YEAR 1977. THESE FORECASTS ASSUME THAT THE YEN APPRECIATION OF THE PAST YEAR AND SLOW GROWTH ABROAD WILL HOLD DOWN JAPANESE EXPORTS AND THAT THIS DEVELOPMENT, ALONG WITH LOW CAPACITY UTILIZATION RATES, WILL CREATE A POOR CLIMATE FOR PRIVATE INVESTMENT. CONSUMER SAVING RATES ARE EXPECTED TO STAY HIGH, AND GROWTH OF CONSUMER INCOMES RELATIVELY LOW. THE GOVERNMENT ANTICIPATES SOMEWHAT STRONGER GROWTH THAN PRIVATE FORECASTERS THAT -- ALONG WITH POTENTIAL SUPPLEMENTAL MEASURES -- WILL BRING GROWTH FOR THE JAPANESE FISCAL YEAR TO 7 PERCENT.

INFLATION HAS TEMPORARILY DISAPPEARED IN JAPAN AS THE APPRECIATION OF THE YEN HAS RESULTED IN DECLINES IN WHOLESALE PRICES OVER THE PAST YEAR AND EVEN SOME MONTHS OF DECLINING CONSUMER PRICES. THIS PRICE PERFORMANCE IS NOT LIKELY TO BE MAINTAINED AS THE EFFECTS OF THE YEN APPRECIATION FADE, BUT VERY MODERATE WAGE INCREASES THIS SPRING WILL MEAN THAT INFLATION IS LIKELY TO REMAIN BELOW HISTORICAL LEVELS THIS YEAR AND PROBABLY NEXT.

THE JAPANESE CURRENT ACCOUNT SURPLUS REACHED 10.9 BILLION
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DOLLARS IN 1977 AS IMPORTS GREW SLOWLY AND EXPORTS SURGED. IN THE FIRST QUARTER OF 1978 THE CURRENT ACCOUNT SURPLUS REACHED 22 BILLION DOLLARS. A DECLINE FROM THIS LEVEL, WHICH PARTLY REFLECTS THE EFFECTS OF YEN APPRECIATION IN RAISING DOLLAR EXPORT PRICES AND ALSO APPEARS TO REFLECT

SEVERAL TEMPORARY FACTORS IS EXPECTED LATER IN THE YEAR AS THE APPRECIATION OF THE YEN BEGINS TO EFFECT TRADE VOLUMES. HOW SOON AND HOW FAST THE SURPLUS WILL COME DOWN IS SUBJECT TO CONSIDERABLE UNCERTAINTY.

PRIVATE INVESTMENT IN JAPAN HAS SLOWED CONSIDERABLY IN THE 1970S. GIVEN THAT THE MEDIUM-TERM GROWTH RATE FOR THE ECONOMY IS EXPECTED TO BE SLOWER THAN BEFORE, THE INVESTMENT SHARE OF GNP IS LIKELY TO REMAIN BELOW THE LEVEL OF THE 1960S. NONETHELESS, THERE IS SCOPE FOR CONSIDERABLY STRONGER INVESTMENT PERFORMANCE. CURRENTLY, LOW CAPACITY UTILIZATION AND THE PROFIT SQUEEZE ON EXPORT INDUSTRIES IS HOLDING DOWN INVESTMENT AND AN INCOMPLETE ADJUSTMENT OF PRICES TO HIGHER ENERGY COSTS MAY ALSO SEEM AS FACTORS. STILL, PRIVATE BUSINESS SURVEYS POINT TO A 9-10 PERCENT NOMINAL INCREASE IN PLANT INVESTMENT DURING THE CURRENT FISCAL YEAR. THE GOVERNMENT HAS TAKEN STEPS TO PROVIDE INVESTMENT INCENTIVES, PARTICULARLY FOR POLLUTION CONTROL AND ELECTRICAL POWER GENERATION.

END TEXT. BEGIN TABLE.

GROWTH IN THE INDUSTRIALIZED COUNTRIES, 1976-1978 (1)

5/16/78

-----	ACTUAL	ACTUAL	CONSENSUS
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-----	1976	1977	1978
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UNITED STATES	6.0	4.9	3.6-4.1
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JAPAN	6.0	5.1	5.0-5.5
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GERMANY	5.7	2.4	2.5-3.0
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FRANCE	4.6	3.0	3.0-3.3
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UNITED KINGDOM	2.0	0.7	2.5-3.0
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CANADA	4.9	2.6	3.8-4.2
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ITALY	5.7	1.7	2.0-2.5
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TOTAL OF ABOVE COUNTRIES	5.5	3.9	3.5-4.0
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EUROPEAN ECONOMIC COMMUNITY	4.5	1.9	2.5-3.0
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SOURCE: HISTORICAL DATA FROM THE OECD

(1) YEAR OVER YEAR PERCENT CHANGE IN REAL GNP (GDP). VANCE

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